Zacks Small-Cap Research

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SMTP Inc. (SMTP-NASDAQ)

SMTP: SharpSpring Competing Well Against MKTO and HUBS; Raising Estimates

Current Recommendation	**Buy**
Prior Recommendation	Buy
Date of Last Change	10/14/2014
Current Price (05/11/15)	$5.65
Target Price	**$13.00**

OUTLOOK

SMTP is a small growing SaaS provider of email delivery services that bought two other email services companies last year to add marketing automation and a front-end for email creation and tracking offerings. These acquisitions should double revenues this year, while increasing the total addressable market for the company. The smaller one, SharpSpring, is proving to be a formidable competitor to MKTO and HUBS. With an enterprise value to sales of 2.0xs 2015 estimated revenues versus peers of 5.8xs, we rate the stock a BUY.

SUMMARY DATA

52-Week High	**$6.66**
52-Week Low	**$4.52**
One-Year Return (%)	**-3.95**
Beta	**-9.01**
Average Daily Volume (sh)	**20,725**
Shares Outstanding (mil)	**5**
Market Capitalization ($mil)	**$31**
Short Interest Ratio (days)	**0.52**
Institutional Ownership (%)	**10**
Insider Ownership (%)	**56**
Annual Cash Dividend	**0**
Dividend Yield (%)	**0**
5-Yr. Historical Growth Rates	
Sales (%)	**21.8**
Earnings Per Share (%)	**N/A**
Dividend (%)	**NM**
P/E using TTM EPS	**21.6**
P/E using 2015 Estimate	**NM**
P/E using 2016 Estimate	**16.8**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small-Blend**
Industry	**Internet-Services**
Zacks Rank in Industry	**8 of 45**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	1.4 A	1.4 A	1.5 A	1.5 A	5.8 A
2014	1.5 A	1.5 A	1.6 A	2.9 A	7.5 A
2015	3.3 A	3.5 E	3.9 E	4.3 E	15.0 E
2016					18.0 E

Earnings per Share
(EPS is fully diluted non-GAAP earnings)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2013	$0.15 A	$0.14 A	$0.17 A	$0.14 A	$0.60 A
2014	$0.09 A	$0.06 A	$0.09 A	-$0.02 A	$0.21 A
2015	-$0.03 A	$0.00 E	$0.03 E	$0.04 E	$0.03 E
2016					$0.35 E

Zacks Projected EPS Growth Rate - Next 5 Years % **25**

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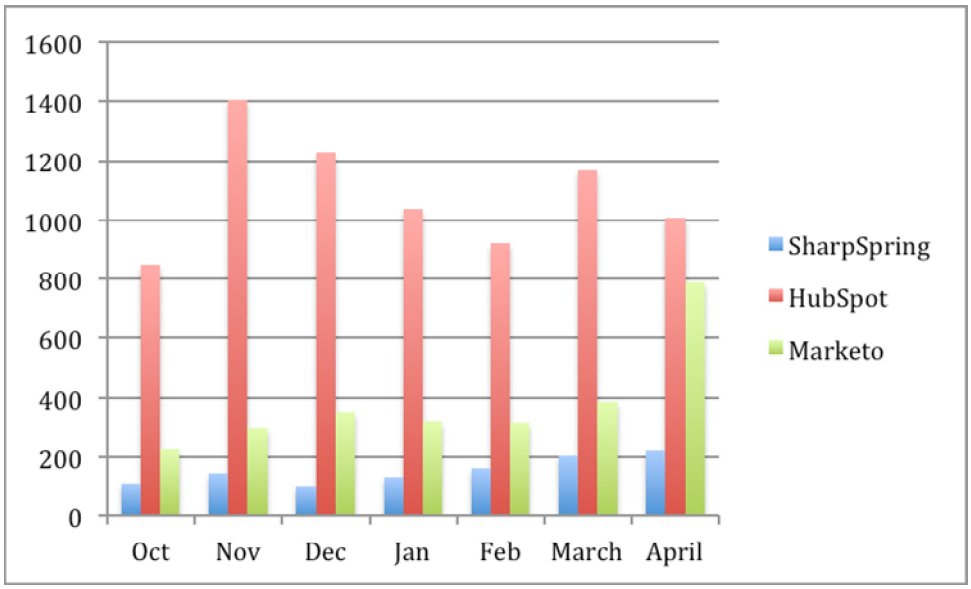
WHAT'S NEW

Revenues beat as SharpSpring Outperforms

In Q1 2015 just reported, we had the first full quarter combining both acquisitions of last year. Revenues were $3.3 million versus $1.6 million in 2014, up 121%. The company should easily double last year's revenue for the full year. This revenue number beat our estimates by $170,000 and we believe it was due to better than expected results at SharpSpring as evidenced by the higher than expected Change in Earn-out Liability taken this quarter as well as the fact this is a seasonally weak quarter for the base SMTP and GraphicMail businesses. Under even the worst-case scenario, SharpSpring is now expected to reach its goal of a $5 million run rate by year-end to earn its earn-out. As a result, the company has now expensed all of the Change in Earn-Out Liability except the time value of money. So rather than the $575,000 we were expecting, the company took $704,000. For the next four quarters we are now expecting the expense will be $399,000 per quarter, with the final quarter falling into 2016.

SharpSpring is accelerating new business as resources are put in place in marketing and sales. It is selling well against Marketo and HubSpot primarily due to its lower cost and flexibility in using other vendor's complementary products. Despite having a very competitive product, SharpSpring is a tiny player in this market. To put it in perspective, SharpSpring may sell around $3.5 million in product this year while HubSpot is forecasted at $166 million in revenues and Marketo is at $209 million. That is a growth of 43% and 39% respectively. Even small inroads against these two could be large revenues for SMTP. According to a third party market research group, Datanyze, Marketo closed only twice as many new customers in the quarter as SharpSpring. Incredible considering it spent $30 million in sales and marketing in the quarter and SMTP spent $1.4 million. The company also announced that SharpSpring added 149 new customers in Q1, which equated to a million in annual revenue. This was 45% more than in Q4. So conservatively if SharpSpring does that in the next three quarters, the company should be able to easily add $4 million in annual revenues to 2016 if the rest of the business does not grow at all. Given these metrics we can see our $18 million revenues estimate for 2016 easily beaten.

Chart 1. Datanyze Net Customer Migration



Gross margin was 75.9% versus 78.0% last year and 76.0% in Q4. This is due primarily to a full quarter of GraphicMail. As SharpSpring becomes a larger portion of sales, we expect this margin to rise.

Expenses were $200,000 more than we expected (excluding change in earn-out liability) due almost entirely to higher S&M expense. Operating loss was $100,000 higher than expected. The company is beginning to build out a modest international sales force. Not only are prices higher overseas, but also the market is less developed and thus the incumbents in the US are not as well known or entrenched. SMTP is having more success with larger companies overseas as they are the first adopters and are still unpenetrated. This is leading to higher ticket sales per customer versus the US. The company added a direct salesperson in the UK and is enjoying a high payback on this investment. It is looking at adding others in other countries.

The biggest difference in the model was the use of a 25% tax rate rather than the 7% we were using. Since company loses money, it reverses the losses.

GAAP EPS came in at a loss of $0.21 versus $0.05 profit and non-GAAP EPS was a loss of $0.03 versus a non-GAAP profit of $0.07 in 2014.

2015

For the full year 2015, we are increasing our revenue estimate to $15 million from $14.1 million, which would be revenue growth of 105%. Since virtually all revenues are recurring, they should build quarter to quarter. We are adjusting our GAAP EPS up to a loss of $0.56 down from of $0.77 due primarily to the higher tax rate of 25% reducing losses. Non-GAAP estimates are being reduced to $0.03 rather than the $0.07 we has been expecting.

2016

In 2016, we expect the company to continue to grow 20%+ as the base business increases 10% and SharpSpring at least 60%. Coming off such a small base this rate could be easily exceeded and we believe this is where the big upside to revenues could be. However the newly invigorated product line could be a boon all around and given the market growth, the company's complete offering and the law of small numbers, this could be exceedingly conservative. For now we expect revenues of $18 million up 20%.

The biggest difference in 2016 will be a higher share count up 10% from the earn-out and the risk of an equity offering further diluting shareholders to raise cash. There will also be $1.5 million in expense removed for the Change in Earn-Out liability versus 2014. Despite the fact we know the company will continue to reinvest in sales and marketing, we do not believe the plan is to lose money in 2015 and believe at worst case the company plans to remain cash flow positive.

Given the huge losses its competitors sustain and their high valuations we are not so concerned with profits as revenue growth, traction and limited shareholder dilution.

INVESTMENT THESIS

- Its recent acquisitions of SharpSpring and GraphicMail should more than triple the companies' addressable market opportunity, make it much more competitive against larger players. It also expands its geographic reach internationally where it has had limited exposure.

- SharpSpring is less expensive, more fully featured direct competitor to Marketo and HubSpot. As investors become more aware of this and compare valuations we believe the stock could appreciate based on the comparison to this highly valued companies. Marketo trades at 5.3x enterprise value to sales and HubSpot 7.3xs.

- With these acquisitions and internal growth, the company may be able to more than double revenues to $15 million in sales. Should the company achieve these numbers we believe the stock would be worth considerably more in the next twelve months.

- The company is trading at 2.0 times enterprise value to sales, well below its peers, which trade at an average enterprise value of 5.8 times sales. We are reiterating our BUY, but have increased our target price slightly to of $13 due to the increase in the valuations of comparable companies and having raised our revenue forecast. This is 130% above the current stock price.

INDUSTRY

SMTP competes in a $2 billion opportunity for email marketing spending worldwide. It has ample new opportunity as it brings its products over seas and sells to a wide range of companies. It is now poised to address companies large and small and has increased GraphicMail's ability to send only a 100,000 emails a month to SMTP industrial strength capability of 100 million emails a month. It has a full service solution for all aspects of email marketing.

VALUATION

SMTP can be valued against other public SaaS companies. Many of the highly valued SaaS companies are not yet profitable, so we use valuation based on a multiple of sales. As shown on the chart below company valuations range from a low of 1.5 times enterprise value to forecasted 2015 revenues for the $300 million, money-losing Jive Software (JIVE), to a high of 13.5 times for $15 billion Workday, which provides a SaaS platform for human resource information systems (HRIS). The group yields an average of 5.8 times forecasted 2015 revenues and 7.5 times trailing twelve month. The valuation of the group has moved up somewhat since we last ran the comparables. Using this current metric, if we plug in SMTP's estimated 2015 and trailing 12 month revenues, we can see the stock moving to $14 by next year if the revenue forecasts are reached. If we use the shares that will be outstanding this time next year, we still reach a price of $13.37. Given the company's current price of $5.89, that is 137% upside.

Company	Ticker	Revenue 2015E	Revenue LTM	EBIDTA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Included in Average?	Enterprise Value
Callidus Software	CALD	$166	$137	-2%	4.1x	5.0x	y	682
Salesforce	CRM	$6,510	$5,370	6%	7.3x	8.9x	y	47,780
Constant Contact	CTCT	$376	$332	14%	2.1x	2.3x	y	775
Ellie Mae	ELLI	$224	$162	20%	8.1x	11.2x	y	1,810
HubSpot	**HUBS**	**$161**	**$116**	**-37%**	**7.3x**	**10.1x**	**y**	**1,170**
Jive Software	JIVE	$197	$179	-22%	1.5x	1.7x	y	296
LogMeIn	LOGM	$264	$222	15%	5.1x	6.0x	y	1,340
Live Person	LPSN	$266	$210	4%	2.2x	2.8x	y	586
Marketo	**MKTO**	**$209**	**$164**	**-32%**	**5.3x**	**6.8x**	**y**	**1,110**
NetSuite	N	$728	$598	-9%	9.8x	11.9x	y	7,110
Realpage	RP	$456	$402	6%	3.3x	3.7x	y	1,488
Syncronoss Technologies	SNCR	$573	$457	26%	3.2x	4.0x	y	1,830
Solarwinds	SWI	$519	$429	36%	6.6x	8.0x	y	3,440
2U Inc.	TWOU	$110	$104	-27%	5.8x	6.2x	y	643
Textura	TXTR	$90	$63	-30%	6.7x	9.6x	y	607
Ultimate Software	ULTI	$617	$506	15%	7.5x	9.2x	y	4,630
Workday	WDAY	$1,140	$788	-20%	13.4x	19.4x	y	15,250
Average				**-2.3%**	**5.8x**	**7.5x**		**$5,326**

	Revenue 2015E	Revenue LTM	EBITDA Margin	Enterprise Value / Sales 2015E	Enterprise Value / Sales LTM	Valuation Range Low	Valuation Range High
SMTP	**$15**	**$9**	**-2.60%**	**5.8x**	**7.5x**	**$69**	**$87**
YoY growth							

Conclusion of Enterprise Value	**$78,347,955**
Market Value	**$80,504,455**
Shares Outstanding	5,494,500
Price per Share	**$14.65**

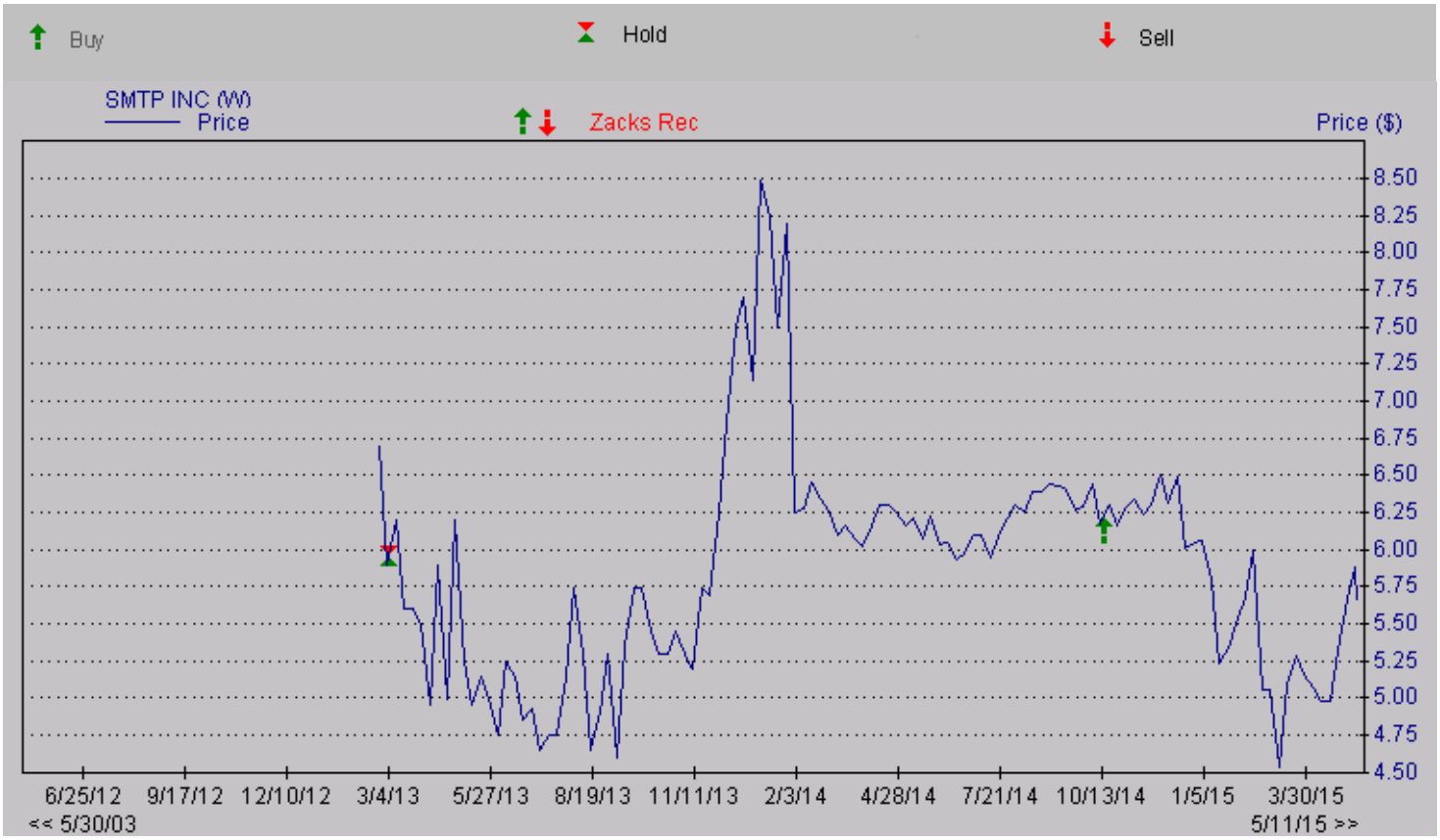
INCOME STATEMENT

	Q1 2014R	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015E	Q3 2015E	Q4 2015E				
	31-Mar	30-Jun	30-Sep	31-Dec	31-Mar	30-Jun	30-Sep	31-Dec	2013	2014	2015E	2016E
Net revenue	**$1,490,054**	**$1,480,770**	**$1,631,244**	**$2,897,429**	**$3,285,502**	**$3,505,770**	**$3,925,000**	**$4,255,000**	**$5,753,929**	**$7,499,497**	**$14,971,272**	**$18,000,000**
Yr-to-yr Growth	8.8%	6.1%	11.0%	90.6%	120.5%	136.8%	140.6%	46.9%	7.5%	30.3%	99.6%	20.2%
Cost of services	327,230	351,153	340,649	696,581	790,966	830,000	940,000	1,010,000	1,049,325	$1,715,613	$3,570,966	3,900,000
Gross profit	1,162,824	1,129,617	1,290,595	2,200,848	2,494,536	2,675,770	2,985,000	3,245,000	4,704,604	5,783,884	11,400,306	14,100,000
Gross Margin	78.0%	76.3%	79.1%	76.0%	75.9%	76.3%	76.1%	76.3%	81.8%	77.1%	76.1%	78.3%
Operating expenses:												
Sales and marketing	168,300	228,013	380,172	1,056,481	1,372,361	1,372,361	1,472,361	1,572,361	817,971	$1,832,966	$5,789,444	6,100,000
General and administrative	483,815	563,786	973,016	1,115,996	1,084,016	1,034,016	1,050,000	1,125,000	1,710,934	$3,136,613	$4,293,032	4,400,000
Research and development	118,622	101,387	141,923	441,495	471,214	475,000	480,000	490,000	234,581	$803,427	$1,916,214	2,000,000
Amortization expense	0		25,667	259,404	378,895	378,895	378,895	378,895	0	$285,071	$1,515,580	1,515,580
Total operating expenses	770,737	893,186	1,520,778	2,873,376	3,306,486	3,260,272	3,381,256	3,566,256	2,763,486	6,058,077	13,514,270	14,015,580
Operating income:	392,087	236,431	(230,183)	(672,528)	(811,950)	(584,502)	(396,256)	(321,256)	1,941,118	(274,193)	(2,113,964)	84,420
	26.3%	16.0%	-14.1%	-23.2%	-24.7%	-16.7%	-10.1%	-7.6%	33.7%	-3.7%	-14.1%	0.5%
Other income:												
Interest income	0	144	367		0	0	0	0	0	0	0	0
Total other income	0	144	367	(6,627)	(50,024)	-	-	-	0	(16,278)	(50,024)	0
Change in earnout liability	0	0	0	(682,000)	(704,000)	(399,000)	(399,000)	(399,000)		(682,000)	(1,901,000)	(399,000)
Loss on disposal of fixed assets	0	0	(10,172)	0	0	0	0	0	0	0	0	0
Income before income taxes	392,087	236,575	(239,988)	(1,361,155)	(1,565,974)	(983,502)	(795,256)	(720,256)	1,941,118	(972,471)	(4,064,988)	84,420
Provision for income tax	168,765	85,367	(142,160)	(243,230)	(395,946)	(245,876)	(198,814)	(180,064)	668,155	(131,258)	(1,020,700)	16,884
Tax rate	43.0%	36.1%	59%	18%	25.3%	25.0%	25.0%	25.0%	34.4%	13.5%	25.1%	20.0%
Net income	$223,322	$151,208	(97,828)	(1,117,925)	(1,170,028)	(737,627)	(596,442)	(540,192)	$1,272,963	(841,213)	(3,044,289)	67,536
Yr-to-yr Growth	-1.0%	-60.8%	-131%	-427%	-624%	-588%	510%	-52%	19.0%	-166.1%	262%	NM
Adj for Non-GAAP	$89,000	$198,431	533,000	1,029,925	1,019,000	$734,921	$734,921	$734,921	$576,822	$1,858,000	3,223,764	$2,035,935
Non-GAAP Income	$312,322	$392,639	435,172	(88,000)	(151,028)	(2,705)	138,479	194,729	$1,849,785	$1,016,787	179,475	$2,103,471
Yr-over-Yr	21%	27%	27%	-3%	-148%	-101%	-68%	-321%	38.2%	-45.0%	-82%	1072.0%
Net income per share:												
Basic	$0.05	0.03	(0.02)	(0.21)	(0.21)	(0.14)	(0.11)	(0.10)	0.42	(0.17)	(0.56)	0.01
Diluted	$0.05	0.03	(0.02)	(0.21)	(0.21)	(0.13)	(0.11)	(0.10)	0.41	(0.17)	(0.55)	0.01
Non-GAAP Diluted	**$0.07**	**$0.08**	**$0.09**	**-$0.02**	**-$0.03**	**-$0.00**	**$0.03**	**$0.04**	**$0.60**	**$0.21**	**$0.03**	**$0.35**
Yr-to-yr Growth	-50.9%	-43.5%	-48.5%	-112.1%	-138%	-101%	-71%	-316%	31.6%	-65.7%	-84.2%	969.3%
Shares												
Basic	4,239,363	5,016,461	5,020,005	5,370,813	5,457,000	5,457,000	5,457,000	5,457,000	3,004,541	4,913,903	5,457,000	6,022,500
Diluted	4,302,443	5,063,993	5,020,005	5,370,813	5,457,000	5,507,000	5,507,000	5,507,000	3,069,274	4,913,903	5,494,500	6,022,500
	34.7%	65.7%	59.9%	69.5%	26.8%	8.7%	9.7%	2.5%	5.0%	60.1%	11.8%	9.6%
Adjusted EBITDA	$578,000		360,000	(52,000)	(106,000)	42,393	230,639	305,639	2,620,000	1,326,000	472,671	2,983,000

BALANCE SHEET

	March 31, 2015	Dec. 31, 2014R	% Change
Assets			
Cash and cash equivalents	$2,156,500	$2,825,520	-24%
Accounts receivable	487,356	393,922	24%
Deferred income taxes	240,650	240,648	0%
Income taxes receivable	774,370	328,802	136%
Other current assets	233,042	197,745	18%
Total current assets	3,891,918	3,986,637	-2%
Property and equipment, net	332,506	281,555	18%
Goodwill	8,893,611	8,901,106	0%
Intangibles	7,445,572	7,895,238	-6%
Deferred income taxes	612,941	612,941	0%
Deposits	28,512	30,172	-6%
Total assets	21,205,060	21,707,649	-2%
Liabilities and Shareholders' Equity			
Accounts payable	355,781	397,263	-10%
Deferred revenue	993,652	1,006,031	-1%
Income taxes payable	13,904	14,622	-5%
Accrued expenses and other current liabilities	227,593	355,796	-36%
Deferred income taxes	5,749	2,118	171%
Total current liabilities	1,596,679	1,775,830	-10%
Earn out liabilities	8,384,096	7,679,311	9%
Total liabilities	9,980,775	9,455,141	6%
Shareholders' equity:			
Preferred stock			
Common stock	5,462	5,447	0%
Additional paid in capital	13,454,283	13,248,992	2%
Accumulated other comprehensive income	(241,238)	(177,767)	36%
Accumulated deficit	(1,994,222)	(824,185)	142%
Total shareholders' equity	11,224,285	12,252,487	-8%
Total liabilities and shareholders' equity	$21,205,060	$21,707,628	-2%
Current Ratio	2.4	2.2	9%

HISTORICAL ZACKS RECOMMENDATIONS



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